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No. 355

In the Supreme Court of the United States

OCTOBER TERM, 1931

FRANK COLLIS BOWERS, AS EXECUTOR OF THE ESTATE OF FRANK K. BOWLES, FORMERLY UNITED STATES COLLECTOR, ETC., DECEASED, PETITIONER

v.

LAWYERS MORTGAGE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY FOR THE PETITIONER

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v.

LAWYERS MORTGAGE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court (R. 15–18) is reported in 34 F. (2d) 504. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 68–73) is reported in 50 F. (2d) 104.

JURISDICTION

The judgment sought to be reviewed was entered June 8, 1931. (R. 74.) Petition for certiorari was

filed on September 5, 1931, and the writ was granted on October 26, 1931. (R. 94.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether Section 1000 (b) of the Revenue Act of 1921, which exempted "any insurance company subject to the tax imposed by section * * * 246" from the capital stock tax imposed by Section 1000 (a), applied to the respondent, a corporation engaged in the business of making mortgage loans and thereafter selling such loans with its "policies of mortgage guaranty."

STATUTES AND REGULATIONS INVOLVED

These will be found in Appendices A to C (*infra*, pp. 42–56).

STATEMENT

The respondent, a New York corporation, on July 29, 1922, voluntarily filed a return for the capital stock tax for the period from July 1, 1922, to June 30, 1923, and on July 27, 1923, voluntarily filed a capital stock tax return for the period from July 1, 1923, to June 30, 1924. On November 3, 1922, the respondent voluntarily paid the tax of $10,147, shown on the first return; and on September 4, 1923, it voluntarily paid the tax of $10,731, shown on the second return. In each of these returns the respondent inserted under the

heading "Nature of business in detail" substantially the following words: "Guaranteed First Mortgages secured by New York Real Estate." (R. 18–20 and Exhibits I and K.)

On or about March 15, 1922, it had filed a consolidated income tax return for the calendar year 1921, for itself and its three subsidiary companies, the Nassau-Maiden Lane Loan Building Corporation, Liberty Brokerage Company, and Elemco Realty Company; and on or about March 14, 1923, it filed a similar return for the year 1922. In each of these it inserted under the heading "Kind of business" the words "Guaranteed Mortgages, etc.," and in each of these it included in its return of gross income its lending and extension fees (hereinafter explained) and capital gains and losses, which corporations generally (as distinguished from insurance companies) were required to report under the Revenue Act of 1921. (R. 20 and Exhibits N and O.)

In none of these four returns did the respondent assert that it was an insurance company.

On November 14, 1923, it filed claims for refund of the capital stock taxes on the ground that it was an insurance company and consequently was exempt from the capital stock taxes paid. (R. 19–20, and Exhibits J and L.) The Commissioner of Internal Revenue rejected the claims and the respondent duly brought this action in the District

Court against the Collector of Internal Revenue[1] to recover the capital stock taxes paid. (R. 2–3.) Written stipulation was filed waiving a jury. (R. 1.) The District Judge found the facts to be as stipulated by the parties and entered judgment against the Collector for the full amount claimed. (R. 18–26, 4.) The Circuit Court of Appeals, with Judge Chase dissenting, affirmed the judgment. (R. 68–74.)

The findings of fact may be epitomized as follows:

The respondent is a corporation duly incorporated as the "Lawyers Mortgage Insurance Company" in 1893, under Article V of the insurance law of the State of New York (Laws of 1892, ch. 690, p. 51, *infra*), pertaining to title and credit guaranty corporations. Its certificate of incorporation was filed in the office of the Superintendent of Insurance of the State of New York. (R. 18–19 and Exhibit A.) By order of the Supreme Court of New York entered October 3, 1903, the name of the respondent was duly changed to "Lawyers Mortgage Company" (R. 18), and on January 10, 1905, the respondent amended the statement of its purposes as contained in its original certificate of incorporation (R. 18–19 and Exhibit B). On December 18, 1913, this certificate, with the consent of the Superintendent of Insurance, was further amended to include in the statement of

[1] The petitioner here is the executor of the estate of the Collector, the Collector having died after appeal was taken to the Circuit Court of Appeals and the executor having come in voluntarily. (R. 69.)

purposes and powers of the company all of those of a title guaranty corporation organized under Article V, section 170, paragraph 1, of the insurance law, as amended by chapter 215 of the Laws of 1913 (pp. 52–53, *infra*) (R. 19 and Exhibit C). Thus it first acquired the right to make and sell loans on mortgages. The respondent has at all times since the date of its incorporation been subject to examination by and supervision of the Superintendent of Insurance of the State of New York, and has been subject to the provisions of the insurance law of that State applicable to so-called title and credit guaranty corporations organized thereunder. It has been required to file and has filed annually with the Superintendent, on forms approved by him, statements of its condition as of December 31 of each year. (R. 18–19 and Exhibits D and E.)

The respondent has never engaged in the business of insuring titles to real estate, although authorized to do so. (R. 20.) Its business is carried on as follows: It receives applications for loans secured by first mortgages on real estate. On receiving such an application it causes an appraisal of the security to be made. If the report of the appraisers is satisfactory, the application is turned over to a title insurance company, which issues a report on the title and furnishes a survey, and, after the loan is closed, delivers a policy of title insurance. Upon closing a loan the applicant exe-

cutes a bond and mortgage to the respondent (Exhibit S) and in return receives the face amount of the bond less charges for the title policy and survey, disbursements, and mortgage recording tax, and less a lending fee, at the prevailing rate, which includes the appraisal charge and which constitutes part of the respondent's gross income. (R. 20–23.) Thereafter the bonds and mortgages, or certificates of participation therein, are sold to investors. When a bond and mortgage are sold, they are assigned and respondent delivers to the investor an assignable "policy of mortgage guaranty." (R. 22 and Exhibit T, R. 57–61.) In the case of the sale of a participation certificate (R. 22 and Exhibit U, R. 61–63) there is incorporated in the certificate itself terms corresponding substantially to those in the "policy." The participation certificate is assignable by endorsement, but only when the assignment is registered on the books of the company.

By the "policy" or the participation certificate, the purchaser or investor appoints the respondent his agent to collect the principal and interest on the bond (by suit if necessary, but without expense to the purchaser), to keep the title guaranteed to the amount of the mortgage, to keep the mortgaged premises insured against fire, and to require the owner thereof to pay all taxes, assessments, water rates, and fire insurance premiums. By the policy or the certificate the respondent guarantees payment of the principal as and when collected, but in any event within eighteen months

after demand in writing by the purchaser after maturity, and also guarantees the payment of interest at a specified rate, which is usually one-half of one per centum less than the rate specified in the bond. This difference, called a "premium," is retained by respondent from the interest collected from the mortgagor. (R. 22.)

In some cases, constituting only a small percentage of its total business, the respondent issues similar policies to holders of outstanding mortgages not sold by the respondent. (R. 22–23.)

The respondent does not make loans for its own investment primarily, but for the purpose of ultimate sale to the general public. In making assignments of bonds and mortgages or of fractional certificates, the respondent always enters into the guaranty described. (R. 23.) The average length of time between the making of loans and their subsequent transfer to investors is not shown. The interest earned in this intervening period is part of respondent's gross income. Upon renewals of loans extension fees are charged at the generally prevailing rates. (R. 23–24.)

The sources and amounts of respondent's income in 1922 and 1923 were as follows (R. 24 and Exhibit M, R. 36):

Year	Fees (lending and extension)	Interest	Total fees and interest	Premiums
1922	$869, 587. 26	$372, 795. 12	$1, 242, 382. 38	$619, 986. 38
1923	1, 064, 601. 08	426, 842. 31	1, 491, 443. 39	795, 803. 21

In conducting its business the respondent did not segregate its assets, but used them indiscriminately in all its activities. It always kept on hand a sufficient quantity of bonds and mortgages to maintain the guaranty fund supposedly required by Article V of the New York insurance law. (R. 25.)

By the law of New York, corporations organized under its banking statutes and subject to supervision by the State Banking Department may make mortgage loans and sell bonds and mortgages and participations therein, with their guaranty, under the same general method of doing business as that of respondent; and at least two companies thus organized and supervised have been and are now so engaged. (R. 16, 24.)

SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred in not holding that the respondent was taxable under Section 1000 of the Revenue Act of 1921.

SUMMARY OF ARGUMENT

Section 1000(a)(1) of the Revenue Act of 1921 provided that every domestic corporation shall pay annually the special excise (capital stock) tax with respect to carrying on or doing business which was levied on the respondent in this case. The respondent contends, and the courts below held, that it was not subject to this kind of a tax because it was an "insurance company subject to the tax imposed

by section * * * 246" within the meaning of paragraph (b) of Section 1000, which provided that the tax imposed by this section should not apply to any such insurance company. The sole question is whether it was such an insurance company.

The statute nowhere defined the words "insurance company." Section 246 imposed "in lieu of the tax imposed by sections 230 [the income tax imposed on corporations generally] and 1000" a tax upon the "net income of every insurance company (other than a life or mutual insurance company)." Subsequent provisions of Section 246 provided that the gross income for corporations taxed under it should include only underwriting income and investment income. Investment income included only interest, dividends, and rents. Before the passage of the Revenue Act of 1921, insurance companies were subject to the same income tax as other corporations. As there is evidence that by Section 246 Congress did not intend to lower the taxes of any company, this section should not be construed to include in the term " insurance company" a company which derives a substantial portion of its income from a distinctive line of business other than that of insurance, as that word is commonly used. Neither the language of the Act nor its legislative history indicates that Congress meant to classify as insurance companies those corporations which are ordinarily known as "mortgage companies" or "investment companies."

The respondent should be classified as an investment company and not as an insurance company. It designated its business as that of "guaranteed mortgages" in its tax returns originally, and advertised that its business was to supply conservative investors with guaranteed mortgages. It lent money in the first instance on the security of real estate mortgages which it approved and was paid by the borrowers for approving. It then tapped the reservoir of money controlled by the investing public to replenish its funds for use for additional lending on mortgages. Even if it is possible to call the contracts made by the respondent "insurance," they were much more than insurance, and it is more natural to consider the whole transaction a part of the investment business. The contracts do not fall within the usual definitions of insurance, but are more analogous to the undertakings of *del credere* agents.

Moreover, the lending fees and extension fees paid by the mortgagors constituted the largest item in the respondent's gross income during the years in question. Together they were almost one-half of its gross income. The business of making such loans was obviously not insurance, and we submit that it cannot be regarded as incidental to the business of guaranteeing mortgages.

The fact that the respondent was organized under the insurance laws of New York and was sub-

ject to the supervision of the insurance superintendent is not conclusive. Under the banking laws of New York corporations could be and were organized to carry on substantially the same business as that carried on by the respondent. It seems reasonable to suppose that the Congress intended that the provisions of the tax law should have uniformity of operation and that it had its own criteria as to what constituted insurance companies, irrespective of local law. The respondent was not designated as an insurance company by the New York law, by itself in its corporate name, in its tax returns, or in its advertisements. *United States* v. *Cambridge Loan & Building Co.*, 278 U. S. 55, appears to be distinguishable from the instant case.

ARGUMENT

Section 1000 (a) (1) of the Revenue Act of 1921 (p. 42, *infra*) provides that "every domestic corporation" should pay annually the special excise (capital stock) tax with respect to carrying on or doing business which was levied on the respondent in this case. There is no question as to the proper amount of the taxes if the respondent was subject to any capital stock tax at all. The respondent contends, and the courts below held, that it was not subject to this kind of tax because it was an "insurance company subject to the tax imposed by section * * * 246," within the meaning of paragraph (b) of Section 1000, which provided

that the taxes imposed by this section should not apply to any such insurance company.[2]

The sole question is whether the respondent during the years in question was an "insurance company subject to the tax imposed by section * * * 246." We contend it was not such a company.

I

THE STATUTE SHOULD NOT BE CONSTRUED TO EXEMPT ANY CORPORATION FROM THE CAPITAL STOCK TAX IF IT DERIVES A SUBSTANTIAL PORTION OF ITS GROSS INCOME FROM A DISTINCTIVE LINE OF BUSINESS OTHER THAN INSURANCE, AS THAT WORD IS COMMONLY USED

The statute nowhere expressly defined the words "insurance company" occurring in Section 1000(b). The definitions in Section 2 of the Revenue Act of 1921 included the following: "The term 'corporation' includes associations, joint-stock companies, and insurance companies." It is not disputed that Section 1000(a) (1), if standing alone, would impose the tax. The burden is upon the respondent to show that it fell within the express exemption of Section 100 (a)—i. e., that it was an "insurance company subject to the tax imposed by section * * * 246."

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[2] Section 1000(b) provided:

"The taxes imposed by this section shall not apply * * * to any insurance company subject to the tax imposed by section 243 or 246."

Section 243 imposed a tax "upon every life insurance company," and consequently has no application to the instant case.

Section 246 (*infra*, p. 43) provided:

> (a) That, in lieu of the taxes imposed by sections 230 and 1000, there shall be levied, collected and paid for the calendar year 1922, and for each taxable year thereafter, upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:
>
> (1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by section 230.

Although it might be argued that this language was applicable to any company (other than a life or mutual insurance company) which does *any insurance business*, neither of the courts below construed the language so broadly, and we do not understand that the respondent's contention goes as far as this. Anyway, a consideration of the general purpose of the Act, and particularly of the subsequent provisions of Section 246 itself, makes it clear that this can not be the correct construction.

Under the 1921 Act, most corporations were required to pay not only the capital stock tax but also the tax on net income imposed by Section 230. Under Section 230 of the 1918 Act, insurance companies were subject to the same tax as other corporations. In computing the tax under Section 230 of both Acts, corporations subject to it were required to include in their gross income—

> gains, profits, and income derived * * * from * * * trades, businesses, com-

> merce, or sales, or dealings in property * * * also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.[3]

In contrast with that broad definition of gross income, Section 246 provided:

> (b) In the case of an insurance company subject to the tax imposed by this section—
>
> (1) The term "gross income" means the combined gross amount, earned during the taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners.

This does not include many kinds of income which were to be included in the gross income of other corporations. Section 247 expressly provided for the deductions of certain kinds of income. The disposition of Congress has been to extend the income tax about as far as it can to all species of income. See *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 235. Apparently there was no design

[3] Section 213, from which the above is quoted, provided that gross income did not include certain specified items, but these need not be considered, as some of them related to kinds of income which an insurance company would never receive, and the rest of them, we believe, were all specifically made deductible, in the case of insurance companies, by Section 247.

to exempt any corporation from anything which was considered as income under Section 213 and which was not made deductible by Section 247;[4] and it seems obvious that the reason why insurance companies taxed under Section 246 were required to report only investment income and underwriting income was because it was contemplated that Section 246 should apply only to corporations substantially all of whose income arose from underwriting or was income on investments.[5] There is no indi-

[4] Except capital gains. It is clear that insurance companies taxable under Section 246 were not required to include such gains. See Art. 692 of Regulations 62, promulgated under the Revenue Act of 1921, *infra*, pp. 48–49. Neither the Act itself nor its legislative history indicates why capital gains were excluded from the income of insurance companies. We understand that the reason why sales of capital assets were not to be included in computing the income tax was that there was a falling market at the time when this matter was considered and it was believed that insurance companies would take losses for tax purposes if sales of capital assets were included. No change was made in the law in regard to this matter until the Revenue Act of 1928, Section 204 (b) (1) (B) of which did provide for the taxation of capital gains. An examination of the 1920 gross income of 50 casualty and miscellaneous insurance companies picked at random from Best's Insurance Reports (Casualty and Miscellaneous Insurance Companies, Eighth Annual Edition) reveals that of the total income of such companies 93.82% was derived from underwriting income and 5.04% from investment income, while only 1.14% was from profits on investments and other miscellaneous sources.

[5] Section 246(b)(3) provided: "The term 'investment income' means the gross amount of income earned during the taxable year from interest, dividends, and rents, * * *." It is consequently clear that "investment income" is not meant to include profits from sales of investments or on placing loans.

cation in the statute that a corporation deriving a substantial amount of income from a business other than underwriting should be treated as "an insurance company" merely because it did some business which might be characterized as insurance. These considerations make it evident that the words "insurance company" were intended to designate only the kinds of corporation which are commonly thought of as insurance companies—i. e., those whose activities are confined to various recognized forms of underwriting and matters normally incidental thereto.

Further support for this view is found in the detailed provisions of Section 246 for computing "underwriting income," which were designed to confine such income to premiums *earned* during the taxable year less losses and expenses incurred. (See p. 44, *infra*.)

In regard to this item the Act provided:

> (5) The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:
>
> From the amount of gross premiums written on insurance contracts during the taxable year deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year; * * *

What part, if any, of the interest which is to be deducted over a period of three years or more under the terms of the "policies of mortgage guaranty" would be earned during any year? And what would constitute "gross premiums *written*" during the year? Obviously these conceptions do not fit the items which the respondent designates "premiums."

Nor do we find any thing in the legislative history of the Act indicating that Congress meant to classify as insurance companies those corporations which are ordinarily known as "mortgage companies" or "investment companies."[6]

Prior to the passage of the Act of 1921 insurance companies were subject to all of the taxes imposed on corporations generally.[7] From the legislative history of the Act it appears that one purpose, perhaps the primary purpose, of inserting special provisions for taxing insurance companies in the Act of 1921 was to clarify the situation and avoid the uncertainty and litigation which had arisen in re-

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[6] In Appendix D, pp. 57–60, we have copied all of the extracts from committee reports which seem to bear upon the matter, except those mentioned on p. 18, *infra*.

[7] For provisions regarding income taxes see Section 10, Revenue Act of 1916, c. 463, 39 Stat. 756, 765, as amended by Section 1206 (1), Title XII, Act of March 3, 1917, c. 159, 39 Stat. 1000; Section 230 (a), Revenue Act of 1918, c. 18, 40 Stat. 1057. For provisions regarding capital stock taxes see Section 407, Revenue Act of 1916, c. 463, 39 Stat. 756, 789–790; Section 1000, Revenue Act of 1918, c. 18, 40 Stat. 1057, 1126.

spect of insurance companies under the previous Acts.[8] The report of the Committee on Ways and Means on the Revenue Bill of 1921 gives an itemized estimate as to the changes in annual receipts of revenue under the proposed law. Although it is quite obvious that the construction of the Act for which the respondent contends would result in substantially lowering the receipts from insurance companies (i. e., if that term should be held to include companies like the respondent), no such change in revenue is suggested in that report. (See Report No. 350, 67th Cong., 1st Sess., pp. 3–4.) And there is also positive evidence that Congress was determined that the change in the method of taxing stock insurance companies other than life insurance companies should in no case result in reducing the taxes paid by such companies. As first introduced in the House, the Revenue Bill of 1921 (H. R. 8245) provided a new method of taxation for life insurance companies only. Sections 246 and 247 were not contained in the bill as it passed the House but were added by Senate Amendment No. 32. Mr. Smoot, Chairman of the Senate Finance Committee, reported this amendment. In the debate upon it the following colloquy occurred (See Cong. Record, 67th Congress, 1st Sess., Part 7, pp. 7158–7159):

> Mr. KING. Mr. President, may I ask my colleague whether, in the examination of

[8] See House Report No. 350, 67th Cong., 1st Sess., *infra*, p. 57.

> these proposed amendments, it has been accurately determined that no deductions or allowances will be made to insurance companies to which they are not entitled, and that no exemptions or extensions of favors will be granted by this legislation?
>
> Mr. SMOOT. There is no doubt of it; and I want to say to my colleague that when this amendment is agreed to, outside of the mutual companies, every insurance company will pay to the Government of the United States a higher tax than it pays to-day.

If companies like the respondent are insurance companies, a large part of their income was exempted from the income tax by this very amendment, and the Senate, at least, labored under a grave misapprehension as to the effect of the Act which it passed.

Moreover, none of the later Revenue Acts requires insurance companies to return as gross income anything except underwriting income and investment income (except that the Revenue Act of 1928 does require the inclusion of capital gains).[9] Consequently if the decision below is affirmed, it would seem that even under the present Revenue Act, as well under the 1921 Act and all subsequent Acts, many companies will escape taxation on a substantial part of their income. It is incon-

[9] See Section 246 of the Revenue Act of 1924, c. 234, 43 Stat. 290; Section 246 of the Revenue Act of 1926, c. 27, 44 Stat. 48; and Section 204 of the Revenue Act of 1928, c. 852, 45 Stat. 844.

ceivable that Congress intended to create such a situation. Unless the language of the statutes clearly demands it—and we submit it does not—they should not be so construed. Cf. *Railroad Co.* v. *Commissioners,* 103 U. S. 1; *Bank of Commerce* v. *Tennessee,* 161 U. S. 134, 146; *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232, 235, *supra.*

The question involved is also closely related to that which arises in connection with the stamp tax laid upon corporate securities.[10] Mortgage guaranty companies have contended that their participation certificates are not "corporate securities" but contracts of insurance, and hence not subject to the stamp tax. In *Mortgage Guarantee Co.* v. *Welch,* 38 F. (2d) 184 (C. C. A. 9th), certiorari denied, 281 U. S. 759, this contention was overruled, but a considerable number of similar suits are now pending. The decision in the instant case may well have an important bearing on these cases.

The provisions of Section 246 of the 1921 Act are in marked contrast with the explicit provisions of Title XI of the Revenue Act of 1918, levying stamp taxes on "mortgage guarantee policies." Paragraph 2 of Schedule A of this title imposed a tax *inter alia*—

> On all bonds executed for indemnifying any person who shall have become bound or

[10] See Section 1107, Schedule A (1) of the Revenue Act of 1921, c. 136, 42 Stat. 303; Section 807, Schedule A (1) of the Revenue Act of 1924, c. 234, 43 Stat. 333; Section 807, Schedule A (1) of the Revenue Act of 1926, c. 27, 44 Stat. 101.

engaged as surety, and on all bonds executed for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, and on all policies of guaranty and fidelity insurance, including policies guaranteeing titles to real estate and mortgage guarantee policies, and on all other bonds of any description, made, issued, or executed, not otherwise provided for in this schedule, except such as may be required in legal proceedings, 50 cents: *Provided,* That where a premium [11] is charged for the issuance, execution, renewal or continuance of such bond the tax shall be 1 cent on each dollar or fractional part thereof of the premium charged: * * *

The court below evidently construed the phrase "any insurance company subject to the tax imposed by section * * * 246" as applying to a company which engaged in activities other than insurance resulting in substantial income, if those activities are "incidental" to the insurance business; and it considered that such activities might be incidental to the business of insurance even if, as in this case, the income from such activities "grew to enormous proportions," provided that it was the

[11] The Bureau construed this language as applying to the "premiums" collected by the respondent, and the respondent paid them without protest or claim of refund. (R. 24–25.)

"outgrowth of the genuine business of insurance." (R. 71.)

We contend that Section 246 included a much smaller class of companies and that its provisions were applicable only to corporations substantially all of whose income arises from the usual functions of insurance companies—writing insurance and making investments of the assets of the company and such other activities as are ordinarily incidental to underwriting.[12] Even if the test is not as severe as that, we submit that a company can not be considered as an insurance company subject to the tax imposed by Section 246 if its greatest source of income is something other than underwriting income or investment income as defined in that section.

If either of the tests which we have suggested is correct, the respondent did not come within the scope of Section 246.

II

THE RESPONDENT SHOULD BE CLASSIFIED AS AN INVESTMENT COMPANY AND NOT AS AN INSURANCE COMPANY

It is significant that in the four different tax returns filed by this company it described its business as that of "guaranteed mortgages," and that it was not until November, 1923, that it asserted that it

[12] This test is that which seems to have been followed in all published rulings of the Bureau. See S. M. 5501, C. B. V-1, 102; G. M. C. 2640, C. B. VI-2, p. 259; G. M. C. 5355, C. B. VII-2, p. 160; G. M. C. 6988, C. B. VIII-2, p. 213.

was an insurance company. It is, perhaps, worthy of mention that in 1903 it eliminated from its corporate name the word "insurance." (R. 18.) In one of its advertisements (Exhibit V, p. 2) the company stated:

> The sole business of this Company is to supply conservative investors with First Mortgages on Manhattan, Bronx, Brooklyn, Queens, Nassau, and Westchester real estate with principal and interest fully guaranteed by this company.

Although this statement may be subject to some explanation, it is an inescapable fact that what the company was really doing was making and selling loans. As Judge Chase said in his dissenting opinion (R. 72):

> What this plaintiff really does is to lend money, in the first instance, on the security of real estate first mortgages which it approves and is paid by the borrower for approving. It then becomes necessary for it to tap the reservoir of money controlled by the investing public to replenish its funds for use for additional lending on first mortgages on real estate.

Even if it is possible to call the contracts made by the respondent "insurance," they are much more than insurance. (See pp. 25–28, *infra*.) It is much more natural to consider the whole transaction a part of an investment business. The statutes of New York permit corporations organized

under the banking laws to make such contracts, and the findings state that at least two companies organized under the banking law did make mortgage loans and sell bonds and mortgages and participations therein with their guaranty in New York City, as their principal business, "under the same general method of doing business" as the respondent. (R. 24.)

It must be borne in mind that from a business point of view the sale of the mortgage and the issuance of the policy is a single transaction. A very large source of the respondent's income was its lending fees. It was able to do business in great volume only because it assigned the mortgages soon after making the loans. The payment by the investor to the respondent of the face amount of the mortgage was a most important element in the transaction. If the respondent had not received these sums, it would not have been able to continue to lend extensively on other mortgages, and its profits would have been tremendously curtailed. What the respondent was really doing was to operate as an investment company, procuring bonds and mortgages and disposing of them in a profitable manner. It would seem that the precise form which the transaction takes can hardly be determinative of whether or not the business is insurance—at least within the meaning of the statute here involved. Cf. *Lederer* v. *Fidelity Trust Co.*, 267 U. S. 17.

If the company had merely sold and assigned the bonds and mortgages, obviously the transactions would not have constituted insurance. Or if, as is customary in some States, the primary obligations of the mortgagors had been negotiable promissory notes and if the company had merely endorsed those notes and assigned the mortgages, the transactions would not have been insurance, although the endorsements would have served to make the company liable on the notes.

Still another form of transaction may be supposed. A company which has obtained mortgages may issue its own obligations in the form of bonds or notes and assign to the purchaser as security a certain mortgage or part of a certain mortgage. Such a transaction would certainly not be called insurance. Cf. *Mortgage Guarantee Co.* v. *Welch*, *supra*.

The steps taken by the respondent in respect of its mortgage loans resulted in creating substantially the same obligations as in the two cases last supposed. Where a mere fractional interest in a mortgage was "assigned," the respondent issued its so-called "guaranteed first-mortgage certificate" to the purchaser (whom the certificate designated as "the assured" or the "holder,") the certificate being assignable by endorsement when the assignment is registered on the books of the company. (R. 11; Exhibit U; R. 61–63.) By this certificate the respondent purported to assign an undivided share

or interest to the extent of a certain principal sum in a specified bond and mortgage. But the same instrument irrevocably constituted the respondent the agent of "the holder" to collect and receive the principal and interest and to exercise all other rights given to the mortgagee by the bond or mortgage. The respondent "guaranteed" to any lawful holder of the certificate payment of interest at a specified rate (which was less than the rate specified in the bond and mortgage) within five days after the same was due under the terms of the bond and mortgage until the principal was paid, and also payment of the principal sum—

> as and when collected, but in any event, within eighteen months after payment shall be demanded by the assured, provided such demand be made in writing after said principal sum shall have become due under the terms of said bond and mortgage, * * *.

It consequently appears that, at least until default by the respondent, the holder of the certificate would be allowed to exercise no rights against the mortgagor. The respondent was liable to make certain payments at certain times, regardless of whether the mortgagor paid or whether he was solvent. The respondent retained the bond and mortgage, the title policy and the fire insurance policies, and presumably the policies were issued to the respondent.

It is true that the purchaser was designated as "the assured," but the word "insure" was nowhere used in the certificate and it was not called a "policy."

It does not appear what percentage of the "premiums" received came from such certificates and what part of them came from the so-called "mortgage guarantee policies."

Although there is a little more basis for considering the mortgage guaranty policies as insurance, the rights and liabilities created by them were much the same as those created by the certificates. A "policy" was issued when the entire mortgage was assigned to a single person. (R. 22, 57–61; Exhibit T.) By this policy the company guaranteed to the holder payment of principal and interest at substantially the same times and upon substantially the same conditions as by the certificate. Here also the respondent was appointed the agent to collect the principal and interest on the bond and to exercise every privilege given by the bond and mortgage. Moreover, the "policy" authorized the respondent to buy in the property in the name of the "assured" and to take possession and management of it upon foreclosure until payment by the respondent to the "assured" or until the expiration of the time for making such payment. The "assured" agreed that the company might retain "as its premium for this guarantee all interest collected in excess of the rate guaranteed." But this so-called "premium" must have been intended to compensate the company for its services in making collections, and the like. And in view

of the fact that the respondent sold the mortgage at its face value, the profit on the transaction with the purchaser was the same as if the respondent had transferred the mortgage to the purchaser for a certain price above its face value.

Whether the issuing of such "policies" under such circumstances might ever properly be called insurance is a matter of considerable doubt. This precise question does not seem to have arisen except in connection with this statute, and the judges who have considered it have not been in agreement. In addition to the opinions in the instant case and those in *United States* v. *Home Title Insurance Company,* No. 356, see *Louisville Title Co.* v. *Lucas,* 27 F. (2d) 413, in which a District Court in Kentucky held that a similar guaranty was not "commonly understood as being a part of or incidental to the insurance business." The court there said:

> Of course, a guaranty of the payment of the obligation of another, according to the terms thereof, is not an insurance contract any more than is the indorsement of a negotiable instrument an insurance contract.

It seems well-nigh impossible to formulate an exact and comprehensive definition of "insurance." Insurance is, however, commonly defined as a contract of indemnity, whereby for an agreed premium one party undertakes to compensate the other for a loss on a specified subject, and property insurance (as distinguished from life insurance) is contem-

plated as a contract of hazard, under which liability arises only upon certain contingencies.[18]

The contracts under consideration here do not fall within these definitions. In the first place, the obligation of the respondent is not to indemnify another for a loss or to pay only in a certain event. The "assured" is not required, or indeed permitted, to seek to recover directly against the mortgagor. Payment to him is not contingent upon his suffering any loss: the company is to pay him certain amounts, regardless whether the mortgagor makes the payments or not. The obligation is absolute. It makes no difference whether the mortgagor is solvent or insolvent, whether the security is ample, or even whether the company itself has collected except as to the *time* for payment of the principal. In a sense, at least, the holder of the policy is insured against no risk; for there was never a moment when he had a risk, and his interest in the obligation of the mortgagor arose only by virtue of a transaction in which the giving of the policy itself was the fundamental feature. The "assured" is merely an investor, who wants to buy the obligation of the respondent and in many cases probably pays little attention to the particular security assigned to him.

Moreover, the one-half of 1% interest which the contracts allow the respondent to retain is not the kind of premium ordinarily known in insurance.

[18] A few typical definitions of insurance are collected in Appendix E, pp. 61–64, *infra*.

The "assured" pays it—if at all—through the mortgagor, but there is no agreement on the part of the assured to pay any part of it, and, as counsel for the respondent stated in the District Court, "the premium * * * might never be collected at all." Although this compensation is designated as a "premium" in the policy (Exhibit T) and the findings state that "in business usage [it] is called a premium," so is the amount above par at which a bond is sold. Moreover, no such designation of the one-half of 1% interest retained is made in the participation certificate.

It is true that there is a certain analogy between ordinary credit insurance [14] and a mortgage guaranty where the mortgage was never held by the guarantor, but the similarity wanes when the guaranty is given only as part of a transaction by which the mortgage is assigned or, in effect, sold. A closer analogy to such a guaranty is the obligation of a commission merchant who, in acting as agent for the sale of goods, guarantees payment as a *del credere* agent or promises absolutely to make payment for the price of goods himself at a certain time. Such contracts are exceedingly common, but we have been unable to find any case in which it has been contended that the obligation of such an

[14] Credit insurance has been held to be insurance. See *People* v. *Mercantile Credit Guarantee Co.*, 166 N. Y. 416, 418; *Shakman* v. *Credit System Co.*, 92 Wis. 366, 374; *State* v. *Phelan*, 66 Mo. App. 548, 559. See also United States Federal Reserve Board Bulletin 8, pp. 66–67, *et seq.*

agent was insurance.[15] Somewhat similar undertakings have been held not to be insurance in New York and other States.[16]

In a sense, innkeepers and common carriers are insurers against certain risks, but it would be absurd to say that a company operating a hotel or railroad was entitled to classification as an insurance company under the revenue laws.

III

THE FEES RECEIVED FROM THE MORTGAGORS WERE SUBSTANTIAL AND WERE NOT INCIDENTAL TO AN INSURANCE BUSINESS

These fees constituted a large part of the gross income of the respondent: during the years 1922 and 1923 the lending fees constituted the largest item in the respondent's gross income,[17] and with the extension fees they constituted almost one-half of the gross income of the respondent.[18] The making of the loans for which these fees were received and the services rendered in connection with them certainly was not insurance of any kind.

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[15] Cf. *State* v. *McAvoy*, 40 R. I. 437, 451; *Wasey* v. *Whitcomb*, 167 Mich. 58, 75; *Loch* v. *Hellman*, 83 N. Y. 601, 603.

[16] See cases on pp. 64 to 67, *infra*.

[17] It does not appear that the respondent segregated its expenses, and the findings give no indication as to the net profits from any distinct phase of the respondent's business.

[18] The exact figures are as follows (R. 24):

	Lending fees	Extension fees	Premiums	Interest
Year 1922	$655, 283. 70	$214, 303. 56	$619, 086. 38	$372, 795. 12
Year 1923	990, 855. 37	73, 745. 71	750, 803. 21	426, 842. 31

The Circuit Court of Appeals disposed of this phase of the respondent's business in the following passages of its opinion (R. 71):

> * * * During the taxable years in question plaintiff's income derived from lending fees and extension fees was nearly half of its total income, and was considerably greater than its "premium" income, and more than twice its "interest" income.
>
> * * * * * *
>
> * * * Such fees we regard as incidental to its business of insuring mortgages. It is true that during the years in question this item grew to enormous proportions, becoming substantially as large as the combined income from premiums and interest. Are we to say that this made plaintiff any less an insurance company? We think not. These incidental fees were the outgrowth of the genuine business of insurance and in earlier years had constituted but a small part of its income. Their tremendous increase in the years in question was during a period of great activity in building loans. Premiums also mounted, but not in like proportion, for they, being based upon interest, were extended throughout the term of the mortgage, while the incidental fees were collected in bulk when the loan was made. It would be possible to say that companies should shift in and out of the class of insurers according as such an incidental item

> of their income rises or falls. But, as the district judge pointed out, such a result would have disadvantages from the standpoint of administering the tax law, and is not a result likely to have been intended by Congress when the character of the taxpayer's business has not changed, and the only difference arises from the sudden flaring of what had previously been clearly an incident.

We submit that nothing in the record justifies the treatment of such fees "as incidental to its business of insuring mortgages." Apparently this conclusion is predicated upon the finding that commencing with the year 1921 there was a marked increase in building activity in New York City and a corresponding increase in the demand for mortgage loans. (R. 25.) Although the District Court found in accordance with the stipulation that "the primary purpose of the plaintiff in making loans on bonds and mortgages is not for investment but for the ultimate sale of the bonds and mortgages" (R. 23), it did not find that the profit derived from lending fees was not at all times an attractive aspect of the business. The record contains no information as to the amount of these fees for any year except 1922 and 1923. The findings do show that in 1913 the respondent's certificate was amended to include certain powers as permitted by the amendment of the law made in 1913. (R. 8, Exhibit C.) The company then, for the first

time, was allowed to lend money on mortgages. An examination of its reports to the Superintendent of Insurance for the State of New York reveals that in every year subsequent to that time its lending fees and extension fees were substantial:[19]

Even if guaranteeing mortgages sold be considered as insurance, the test which we have suggested as to what constitutes an insurance company subject to the tax imposed by Section 246 would rarely involve shifting a company like the respondent in and out of the class of insurers from year to year—probably only at times when it consciously amends its charter or its program. The instant case presents no difficulty of this kind, as its appears that during the years in question and for several years prior thereto a large percentage of the company's income came from a business which can not be regarded as insurance.

We submit that a corporation should be classified according to its activities during the year involved and not according to its original purposes. Cf. *United States* v. *Emery Bird, Thayer Realty Company*, 237 U. S. 28. Any disadvantages from the standpoint of administering the tax law which may-

[19] The figures are as follows:

Year	Lending and extension fees	Total income	Year	Lending and extension fees	Total income
1914	$189,281.59	$1,247,283.69	1918	$89,821.38	$1,184,840.29
1915	139,147.40	1,099,975.47	1919	184,782.50	1,287,531.64
1916	166,080.94	1,159,267.16	1920	392,665.87	1,591,006.52
1917	125,174.86	1,224,352.37	1921	498,654.99	1,649,735.57

arise from the test which we support seem far less serious than the wholesale exemption of income from taxation which will result from an affirmance of the decision of the court below.

Another very substantial item in the respondent's revenue was interest received, this having been approximately one-fifth of its entire income during the years 1922 and 1923. It is true that insurance companies of all kinds normally make investments of their assets from which they receive substantial amounts as dividends or interest. But ordinarily insurance companies invest their funds primarily for purposes of investment. This company, as has been pointed out, did not make the loans primarily for that purpose. Certainly the collection of such interest is not insurance, and, although the receipt of interest on investments may be a customary part of the activities of an insurance company, it is also a customary part of the activities of other types of corporations.

IV

THE FACT THAT THE RESPONDENT WAS INCORPORATED UNDER THE INSURANCE LAW OF NEW YORK IS NOT SIGNIFICANT

The opinion of the Circuit Court of Appeals in this case was handed down at the same time as its opinion in *Home Title Insurance Co.* v. *United States*, 50 F. (2d) 107 (pending in this Court as No. 356, October Term, 1931). In the *Home Title*

case the court said that the fact that the State "accepted plaintiff as an insurance company and subjected it to supervision by the department of insurance * * * should turn the scales if the question hangs in doubt," and presumably the decision in the instant case was influenced to some extent by this consideration.

We submit, however, that these facts are not conclusive or especially significant, and that they should not "turn the scales" in favor of the respondent here.

The New York statutes, under which the respondent was incorporated and in compliance with which it filed reports, were regulatory, and probably were designed primarily for the protection of the public. The placing of companies like the respondent under the supervision of the Insurance Superintendent evidently was due to administrative convenience rather than anything else. It is significant that the New York statute (p. 55, *infra*) requires "every corporation engaged wholly or *in part* in the transaction of the business of insurance in this state" to file statements with the Superintendent.

As we have pointed out, corporations organized under the banking laws of the State and subject to the supervision of the banking department are authorized to make mortgage loans and sell the same with their guaranty, and the record discloses that during the years in question two such corporations were regularly engaged in substantially the

same manner as was the respondent in selling to the investing public mortgages and participations in mortgages guaranteed by them. Such corporations were not required to make any reports to the Insurance Superintendent under the statute quoted above. This indicates that the business which was common to the respondent and such corporations was really not regarded as insurance by the State of New York. We submit that it is impossible that Congress intended that of two companies in a State which were carrying on substantially the same business, one should be subject to the tax because it happened to be organized under the banking laws, while the other should be exempt because it happened to be organized under the insurance laws.

The Circuit Court of Appeals regarded the case of *United States* v. *Cambridge Loan & Building Co.*, 278 U. S. 55, as apposite. There the Court held that a corporation was within the exemption from income tax granted by Section 231 of the Revenue Acts of 1918 and 1921 on the ground that it was a "domestic building and loan association," although it received deposits from persons who were not members and made loans to such persons. The Court alluded to the fact that the respondent was called a building and loan association by the Ohio statute under which it was organized, and said (p. 59):

> The statutes speak of "domestic" associations, that is, associations sanctioned by the several States. They must be taken to ac-

> cept, with the qualifications expressly stated, what the States are content to recognize, unless there is a gross misuse of the name. The State of Ohio has recognized and still recognizes the respondent as belonging to the class which its name indicates. Very possibly the company has strained its privileges to near the limit, but we are not prepared to condemn the nomenclature adopted by the State.

Other considerations also seem to have influenced the Court, but we do not regard even the passage of the opinion quoted above as applicable to the case at bar. For here the New York statute did not designate companies like the respondent as insurance companies, and long before the taxable years the respondent itself eliminated the word "insurance" from its corporate name. As has been pointed out, it did not describe itself as an insurance company in its tax returns.

Anyway, it would seem that Section 246 of the Revenue Act of 1921 indicated that Congress had its own criteria of insurance companies, irrespective of local law, and that it must have intended that its provisions should have uniformity of operation. Cf. *Weiss* v. *Wiener,* 279 U. S. 333, 337; *United States* v. *Childs,* 266 U. S. 304, 309.

The attitude of the respondent here in connection with its income taxes illustrates the difficulty in regarding it as an insurance company. It reported as income its lending fees and renewal fees, although it would seem that Section 246 did

not require this, as they are neither "underwriting income" nor "investment income." Apparently it has never asserted that it should escape paying an income tax on these items. Yet, as the exemption of Section 1000(b), upon which the respondent relies, applied only to an "insurance company subject to the tax imposed by section * * * 246," it can hardly assert that it was exempt from the excise tax under Section 1000 while subject, not to the tax imposed by Section 246, but to the tax imposed on commercial corporations generally by Section 230. For Section 246 provided that taxes imposed by it were "in lieu of the taxes imposed by sections 230 and 1000." If the respondent's position in the instant case is tenable, it seems somewhat difficult to sustain even the decision in *Title Guarantee & Trust Co.* v. *United States*, 49 F. (2d) 641 (S. D. Cal.). There a corporation, which complied with the requirements of the statutes of California regarding the insurance business also maintained a trust department which was under the inspection of the banking commissioner. It contended that it was taxable under Section 246 and that consequently certain items, including escrow fees, were not taxable. These fees were charged to persons arranging to purchase property, to negotiate a mortgage, or to consummate any transaction wherein documents were to be delivered or title passed upon title being shown as required. The company acted as a searcher of records in its title department, and sometimes is-

sued policies of title insurance which the court considered to be "strictly * * * 'insurance.'" The court said (p. 643):

> The argument on behalf of the plaintiff is that the main and principal business of the corporation is that of title insurance, and that the trust department and the escrow department are merely incidental and contributing agencies. * * * It is said that the escrow business is a necessary and natural feeder to such insurance business.
>
> * * * The corporation here had the option of limiting its business operations and functions to those which are the well-known attributes of insurance writing, but it can not combine with insurance work a variety of other classes of profitable business and claim the exempt status which will result in its being relieved of a considerable tax which it would have to pay were the business other than insurance conducted separately. It would seem to be just as reasonable to argue that this company might engage in real estate brokerage, and maintain the claim that that business was merely an incidental adjunct operating as a "feeder" to its title insurance business, as to say that its trust department and also its escrow department were merely incidental to the insurance business. To so expand the business permitted of an insurance concern would result in a situation that certainly was not contemplated when the statute was passed.

CONCLUSION

We respectfully submit that the judgment of the court below should be reversed.

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JANUARY, 1932.

APPENDIX A

FEDERAL STATUTES

Revenue Act of 1921, c. 136, 42 Stat. 227, 252, 262, 263, 294:

CAPITAL-STOCK TAX

SEC. 1000. (a) That on and after July 1, 1922, in lieu of the tax imposed by section 1000 of the Revenue Act of 1918—

(1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;

(2) Every foreign corporation shall pay annually a special excise tax with respect to carrying on or doing business in the United States, equivalent to $1 for each $1,000 of the average amount of capital employed in the transaction of its business in the United States during the preceding year ending June 30.

(b) The taxes imposed by this section shall not apply in any year to any corporation which was not engaged in business (or, in the case of a foreign corporation, not engaged in business in the United States) during the preceding year ending June 30, nor to any corporation enumerated in section

231, nor to any insurance company subject to the tax imposed by section 243 or 246.

(c) Section 257 shall apply to all returns filed with the Commissioner for purposes of the tax imposed by this section.

(Section 231 enumerates in fourteen paragraphs organizations which are exempt from taxation, including labor and agricultural organizations, mutual savings banks, etc. This is in no way involved in this case. Section 243 imposes a tax upon the net income "of every life insurance company" and is not here involved. Section 257 provides that the returns shall be public records.)

TAXES ON INSURANCE COMPANIES

SEC. 246. (a) That, in lieu of the taxes imposed by sections 230 and 1000, there shall be levied, collected and paid for the calendar year 1922, and for each taxable year thereafter, upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company the same percentage of its net income as is imposed upon other corporations by section 230;

* * * * *

(b) In the case of an insurance company subject to the tax imposed by this section—

(1) The term "gross income" means the combined gross amount, earned during the taxable year, from investment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;

(2) The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247;

(3) The term "investment income" means the gross amount of income earned during the taxable year from interest, dividends and rents, computed as follows:

To all interest, dividends, and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) The term "losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end

of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) The term "expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by section 247.

SEC. 247. (a) That in computing the net income of an insurance company subject to the tax imposed by section 246 there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in paragraph (1) of subdivision (a) of section 234;

(2) All interest as provided in paragraph (2) of subdivision (a) of section 234;

(3) Taxes as provided in paragraph (3) of subdivision (a) of section 234;

(4) Losses incurred;

(5) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(6) The amount received as dividends from corporations as provided in paragraph (6) of subdivision (a) of section 234;

(7) The amount of interest earned during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt

from taxation under this title, and the amount of interest allowed as a credit under subdivision (a) of section 236;

(8) A reasonable allowance, for the exhaustion, wear and tear of property, as provided in paragraph (7) of subdivision (a) of section 234;

(9) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $2,000; but if the net income is more than $25,000 the tax imposed by section 246 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

* * * * *

TAX ON CORPORATIONS

SEC. 230. That, in lieu of the tax imposed by section 230 of the Revenue Act of 1918, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(a) For the calendar year 1921, 10 per centum of the amount of the net income in excess of the credits provided in section 236; and

(b) For each calendar year thereafter, 12½ per centum of such excess amount.

APPENDIX B

REGULATIONS

Treasury Regulations 62, promulgated under the Revenue Act of 1921.

ART. 691. *Tax on insurance companies.*—For the calendar year 1921 all insurance companies (other than life) are subject to taxes imposed by sections 230 (corporation income tax) and 1000 (capital stock tax) and Title III (war profits and excess-profits tax). For the calendar year 1922 and thereafter, however, in lieu of such taxes, insurance companies, except life and mutual companies, are subject to the tax imposed by section 246. Mutual insurance companies (other than life) remain subject to the taxes imposed by sections 230 and 1000. In articles 691–693 the term "insurance companies" means only those companies subject to the tax imposed by section 246. The rate of the tax imposed by section 246 is the same as the rate imposed by section 230 (12½ per cent), but the net income upon which the tax is imposed, as defined in sections 246 and 247, differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 204 (net losses) but not of section 206 (capital net gain). All provisions of the statute and of these regulations not inconsistent with the specific provisions of sections 246 and 247 are applicable to the assessment and collection of this tax, and insurance companies are subject to the same penalties as provided in the case of returns and payment

of income tax by other corporations. Since section 246 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar-year basis, the first returns under section 246 will be for the taxable year ending December 31, 1922, and will be made on or before March 15, 1923.

ART. 692. *Gross income of insurance companies.*—Net income is gross income as defined in section 246 less the deductions allowed in section 247. Gross income is the combined gross amount earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners. Gross income does not include gain derived from sale or disposition of capital assets, nor are losses sustained from such sale or disposition allowable deductions. It does not include increase in liabilities during the year on account of reinsurance treaties; remittances from home office of a foreign insurance company to United States branch; borrowed money; gross profit on maturity of capital assets; gross increase due to adjustments in book value of capital assets and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the statute will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income

as defined in the statute. By reason of the definition of investment income, profit or loss on investment items is ignored, as well as those miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits. Gain or loss from agency balances and bills receivable not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts, or having been previously charged off are recovered during the taxable year.

ART. 693. *Deductions allowed insurance companies.*—Insurance companies are entitled to the deductions specified in section 247. The deduction of $2,000 allowed domestic companies with net income not exceeding $25,000 is identical with the specific credit allowed other corporations by section 236 (b) and there is the same equalizing provision in the case of incomes slightly in excess of $25,000. See article 591. A domestic insurance company is also entitled to the credit for income, war profits, and excess-profits taxes paid during the taxable year to any foreign country or to any possession of the United States which is allowed other domestic corporations by section 238. See article 611. Among the items which may not be deducted are income and profits taxes, paid or accrued, imposed by the United States and so much of the income and profits taxes imposed by any foreign country or possession of the United States as is allowed as a credit under section 238; taxes assessed against local benefits; donations; de-

crease during the year due to adjustments in book value of capital assets; decrease in liabilities during the year on account of reinsurance treaties; dividends paid to stockholders; remittances to home office of a foreign insurance company by United States branch; and borrowed money repaid.

APPENDIX C

NEW YORK STATUTES

Laws of New York, 1892, c. 690, Vol. 2:

ARTICLE V

TITLE AND CREDIT GUARANTY CORPORATIONS

§ 170. *Incorporation.*—Five or more persons may form a corporation for either one or the other of the following purposes:

I. To examine titles to real property and chattels real, to procure and furnish information in relation thereto, make and guarantee the correctness of searches for all instruments, liens or charges affecting the same; and guarantee or insure bonds and mortgages and the owners of real property and chattels real and other interested therein against loss by reason of defective titles thereto and other incumbrances thereon, which shall be known as a title guaranty corporation;

The above provisions were amended by the Laws of New York, 1900, c. 226, Vol. 1; Laws of New York, 1901, c. 677, Vol. 2; Laws of New York, 1904, c. 543, Vol. 2; Laws of New York, 1909, c. 302, Vol. 1; Laws of New York, 1911, c. 525, Vol. 2; Laws of New York, 1913, c. 81, Vol. 1; and Laws of New York, 1913, c. 215, Vol. 1. The amendment made by the Laws of 1913, c. 215, was the law which was in effect when the respondent amended its charter

in 1913 and also was in effect during the taxable years here involved. This chapter reads as follows:

SECTION 1. Section one hundred and seventy of chapter thirty-three of the laws of nineteen hundred and nine, entitled "An act in relation to insurance corporations, constituting chapter twenty-eight of the consolidated laws," as amended by chapter three hundred and two of the laws of nineteen hundred and nine and chapter five hundred and twenty-five of the laws of nineteen hundred and eleven, is hereby amended to read as follows:

§ 170. *Incorporation.*—Five or more persons may form a corporation for one of the following purposes:

1. To examine titles to real property and chattels real, to procure and furnish information in relation thereto, make and guarantee the correctness of searches for all instruments, liens or charges affecting the same, guarantee or insure the payment of bonds and mortgages, or notes of individuals or partnerships secured by mortgages upon real property situated in this or any other state, and bonds, notes, debentures and other evidences of indebtedness of solvent corporations secured by deed of trust or mortgage upon real property situated in this or any other state, invest in, purchase and sell, with such guarantee or with guarantee only against loss by reason of defective title or incumbrances, bonds and mortgages, and notes of individuals or partnerships secured by mortgages upon improved and unincumbered real property situated in this or any other state worth fifty per centum more than the amount loaned thereon, and bonds, notes, debentures and other evidences of indebtedness of solvent corporations secured by deed

of trust or mortgages upon improved and unincumbered real property situated in this state or outside of this state worth fifty per centum more than the amount loaned thereon, and guarantee and insure the owners of real property and chattels real and others interested therein against the loss by reason of defective titles thereto and other incumbrances thereon, which shall be known as a title guaranty corporation; or

* * *

Laws of New York, 1901, c. 677, §2, as amended by Laws of 1916, c. 345, and Laws of 1929, c. 290, §3.

SEC. 174. *Merger.*—Any two or more corporations organized under subdivision one of section one hundred and seventy of this chapter, or organized under the laws of this state for the purposes or either of them mentioned in subdivision one of section one hundred and seventy of this chapter; or any one or more corporations organized under subdivision one of section one hundred and seventy of this chapter, or organized under the laws of this state for the purposes or either of them mentioned in subdivision one of section one hundred and seventy of this chapter, and any one or more corporations organized under article five of the banking law or under the laws of this state for the purposes or either of them mentioned in article five of the banking law; or any one or more corporations organized under subdivision one of section one hundred and seventy of this chapter, or organized under the laws of this state for the purposes or either of them mentioned in subdivision one of section one hundred and seventy of this chapter, and any

one or more corporations organized under article seven of the banking law or under the laws of this state for the purposes or either of them mentioned in article seven of the banking law, are hereby authorized to merge one or more of said corporations into another in the manner following: * * * Upon the merger of any corporation in the manner herein provided, all and singular the rights, franchises and interests of the said corporation so merged in and to every species of property, real, personal and mixed, and things in action thereunto belonging, shall be deemed as transferred to and vested in such corporation into which it has been merged, without any other deed or transfer; and the said last-named corporation shall hold and enjoy the same and all rights of property, franchises and interests in the same manner and to the same extent as if the said corporation so merged had retained the title, and continued to transact the business of such corporation; and the corporation into which merger has been made shall acquire, possess and retain all rights and privileges belonging to either of said corporations at the time of such merger provided that if one of the parties to such agreement be a corporation organized under article seven of the banking law, or under the laws of this state for the purposes or either of them mentioned in article seven of the banking law, the corporation into which merger has been made shall acquire, possess and retain only such rights and privileges to do business belonging to either of said corporations at the time of such merger as may at that time be possessed by the corporation into which they are merged, and shall

be subject only to the supervision of that department of the state government which theretofore had supervision over the corporation into which they are merged.

Section 16, c. 634, Laws of New York, 1910, amending Section 44 of c. 690, Laws, 1892, as amended by c. 493, Laws, 1897:

SEC. 44. *Reports of corporations.*—Every corporation, engaged wholly or in part in the transaction of the business of insurance in this state, whether heretofore or hereafter incorporated by a general or special law, shall annually, on the first day of January, or within two months thereafter, if a corporation under article two of this chapter, and on or before the fifteenth day of February, if a corporation under the other articles of this chapter, file in the office of the superintendent of insurance a statement verified by the oath of at least two of the principal officers of such corporation, showing its condition on the thirty-first day of December then next preceding, which shall be in such form and shall contain such matters as the superintendent shall prescribe. If a foreign corporation incorporated under the laws of a state or country outside of the United States, such oath may be made by the manager thereof within the United States. The superintendent may also address any inquiry to any such insurance corporation or its officers in relation to its doings or condition, or any other matter connected with its transactions. Every corporation so addressed shall promptly and truthfully reply in writing to any such inquiries, and such reply shall be verified, if required by the superintendent, by such officer of the corporation as he shall designate.

Laws of New York, 1914, c. 369:

SEC. 293. *General powers.*—In addition to the powers conferred by the general and stock corporation laws, an investment company shall, subject to the restrictions and limitations contained in this article, have the following powers:

1. To sell, offer for sale or negotiate bonds or notes secured by deed of trust or mortgages on real property situated in this state or outside of this state, or choses in action owned, issued, negotiated or guaranteed by it; to advance money upon the security of such bonds, notes or choses in action; to purchase or otherwise acquire such bonds, notes or choses in action and to pledge them to secure the payment of collateral trust bonds or notes; to sell or otherwise negotiate such collateral trust bonds or notes. [As amended by L. 1916, ch. 247, by adding the matter from the first semicolon to the end of the subdivision.]

SEC. 298. *Reports to superintendent; penalty for failure to make.*—On or before the first day of February in each year, every investment company and every foreign corporation licensed by the superintendent to transact the business of an investment company in this state, shall make a written report to the superintendent of banks which shall contain a statement of its condition on the morning of the first day of January in said year and shall be in the form and contain the matters prescribed by the superintendent. * * *

APPENDIX D

LEGISLATIVE HISTORY OF REVENUE ACT OF 1921

Report of Committee on Ways and Means, 67th Congress, 1st Session, Report No. 350, to accompany H. R. 8245 (p. 14):

LIFE INSURANCE COMPANIES

Sections 242–246: The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deduction for expenses fairly chargeable against such investment income. The new tax would yield a larger revenue than the taxes which it is proposed to replace.

* * * * *

Senate Report No. 275, Calendar No. 289, 67th Congress, 1st Session, to accompany H. R. 8245 (p. 20):

TAXES ON LIFE INSURANCE COMPANIES

Sections 242–246 provide a new plan for the taxation of life insurance companies, substantially similar to the plan embodied in the revenue act of 1918 as first adopted by the Senate. The provisions of the present

law applicable to life insurance companies are imperfect and productive of constant litigation. The proposed plan would tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses fairly chargeable against such investment income. The new tax would take the place of the present income and excess-profits taxes for the year 1921, and life insurance companies would share with other insurance companies in the repeal in the year 1922 of the capital stock tax and the taxes imposed by section 503. The new tax will yield a larger revenue than the taxes which it is proposed to replace.

Senate Document No. 73, 67th Congress, 1st Session (copy of the bill H. R. 8245) to reduce and equalize taxation (p. 107):

"~~SEC.~~ SEC. *246*. That every *life* insurance company not exempt under the provisions of section 231 shall make a return for the purposes of this Act. Such returns shall be made, and the taxes imposed by section 243 shall be paid, at the same times and places, in the same manner, and subject to the same conditions and penalties as provided in the case of returns and payment of income tax by other corporations, and all the provisions of this title not inapplicable, including penalties, are hereby made applicable to the assessment and collection of the taxes imposed by section ~~243~~" *243*.

(As printed the document shows the House Bill in Roman; All committee amendments in stricken-through type or italic, with such parts of committee amendments as reenact the present law of 1918 in

small capital italic, and new matter in regular italic.)

House of Representatives Report No. 486, 67th Congress, 1st Session, Conference report to accompany H. R. 8245 (pp. 39, 40, 41):

> Amendment No. 463: The House inserted in the bill a section providing for a new system of taxing life insurance companies, beginning with the calendar year 1922. The Senate amendment made the new system of taxing life insurance companies begin with the year 1921; and the House recedes. * * *
>
> Amendment No. 464. The House bill made the new system of taxing life insurance companies also applicable to other kinds of insurance companies. The Senate, by this amendment, made the scheme applicable only to life insurance companies and by amendment No. 495 provided a still different method of taxing certain other insurance companies; and the House recedes.
>
> * * * * *
>
> Amendment No. 495: The House bill provided specifically that every insurance company not exempt under the provisions of section 231 shall make a return for the purposes of this act. As section 239 provides that corporations (including insurance companies) subject to taxation under Title II shall make returns, Senate amendment No. 495 strikes out the above provision of the House bill as surplusage and provides a new system of taxing insurance companies (other than life or mutual insurance companies). The Senate amendment defines the term "gross income" of such companies to mean the combined gross amount earned during the taxable year from investment income and from underwriting income computed

on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners. "Expenses incurred" are defined to mean all expenses shown on the aforementioned annual statement approved by the National Convention of Insurance Commissioners; but for the purpose of computing taxable net income only those expenses specifically allowed may be deducted. The House recedes with an amendment making clerical changes.

SECTION 246 OF THE REVENUE ACT OF 1924

Senate Report No. 398, Calendar No. 388, 68th Congress, 1st Session (p. 29):

Section 243: The rate of tax upon insurance companies taxed under this section and section 246 has been retained at 12½ per cent, as in the existing law. Since these companies are not subject to the capital stock tax under the existing law, the repeal of that tax does not affect them, and consequently does not justify an increase in the rate of income tax upon them.

APPENDIX E

DEFINITIONS OF INSURANCE AND CASES THROWING LIGHT ON THE QUESTION OF WHAT CONSTITUTES INSURANCE

In *Imperial Fire Insurance Co.* v. *Coos County,* 151 U. S. 452, 462, the Court said:

> Contracts of insurance are contracts of indemnity upon the terms and conditions specified in the policy or policies, embodying the agreement of the parties. For a comparatively small consideration the insurer undertakes to guaranty the insured against loss or damage, upon the terms and conditions agreed upon, * * *

In *Washington Central Bank* v. *Hume,* 128 U. S. 195, 205, the Court said:

> * * * Marine and fire insurance is considered as strictly an indemnity; but while this is not so as to life insurance, which is simply a contract, so far as the company is concerned, to pay a certain sum of money upon the occurrence of an event which is sure at some time to happen, in consideration of the payment of the premiums as stipulated, nevertheless the contract is also a contract of indemnity. * * *

In *Empire Development Co.* v. *Title G. & T. Co.,* 225 N. Y. 53, 58, the court said:

> It has been said often that every policy of insurance is a contract of indemnity. The accuracy of this statement is a question of definition. If it means that wagers are pro-

> hibited; that the insured must possess an insurable interest, it is true to-day. But if the word "indemnity" is given a broader sense; if it means that whatever the language of the contract the insured may recover only the precise amount of the pecuniary damage caused to him by the contingency against which he seeks protection, then it is not now and never has been the inflexible rule.

One of the definitions of insurance most often quoted is the following, given in *Commonwealth* v. *Wetherbee,* 105 Mass. 149, 160:

> * * * an agreement by which one party, for a consideration (which is usually paid in money either in one sum or at different times during the continuance of the contract of the risk), promises to make a certain payment of money upon the destruction or injury of something in which the other party has an interest.

This definition was adopted by Massachusetts Insurance Act of 1887, c. 214, par. 3. See *Claflin* v. *United States Credit System Co.,* 165 Mass. 501, 502.

In *Glendale Manufacturing Co.* v. *The Protection Insurance Co.,* 21 Conn. 19, 31, the court said:

> The contract of insurance, as all know, is a contract of indemnity, upon the terms and conditions specified in the policy of insurance. It is a peculiar contract—and one of hazard purely. The insurer undertakes, for a comparatively small premium, to guaranty the insured against loss or damage, upon the exact terms and conditions agreed on, and upon no other. * * *

Bouvier's Law Dictionary (Unabridged, Rawle's Third Revision), defines insurance as follows:

> A contract whereby, for an agreed premium, one party undertakes to compensate the other for loss on a specified subject by specified perils.

The Standard Dictionary defines insurance as follows:

> An act or system of insuring or assuring against loss; specifically, the act or system by or under which indemnity or pecuniary payment is guaranteed by one party (as a company, society, association, or individual) or several parties to another party in certain contingencies under specified terms; * * * a contract whereby one party, in consideration of a stipulated consideration or premium, undertakes to pay a given sum or sums upon the occurrence of a certain contingency, as upon injury to one's person, or upon one's death, or upon the destruction of one's property by fire or otherwise.

The opinion in *People* v. *Rose,* 174 Ill. 310, copies many definitions of insurance, and among them the following:

> Insurance is a contract whereby one, for a consideration, undertakes to compensate another if he shall suffer loss. Such, in its most general terms, is the definition of the contract which is to constitute the subject of the following chapters. It is substantially the definition given long ago by Roccus, and is recommended alike by its brevity and its comprehensiveness—qualities upon which subsequent writers have scarcely been able to improve. * * * It had its origin in the necessities of commerce. It has kept pace with its progress, expanded to meet its rising wants and to cover its ever widening fields, and, under the guidance of the spirit of modern enterprise tempered by a prudent

forecast, it has, from time to time, with wonderful facility adapted itself to the new interests of an advancing civilization. It is applicable to every form of possible loss. Wherever danger is apprehended or protection required it holds out its fostering hand and promises indemnity. 1 May on Insurance, secs. 1, 2.

* * * * *

In law, a contract by which one party, for an agreed consideration, which is proportioned to the risk involved, undertakes to compensate the other for loss on a specified thing from specified causes. Century Dic., "Insurance."

* * * * *

For further definitions and references to cases as to what constitutes insurance, see 63 A. L. R. 711; 47 L. R. A. (N. S.) 291.

CASES HOLDING THAT VARIOUS CONTRACTS WERE NOT INSURANCE

In *Stern* v. *Rosenthal,* 71 Misc. (N. Y.) 422, the plaintiff entered into an oral agreement with the defendants under which the latter hired the plaintiff to make up trousers material supplied by the defendants. In consideration of the payment by the plaintiff of one dollar to be deducted by defendants from every $100 worth of work done upon defendants' material by plaintiff, the defendants agreed to pay plaintiff the value of the labor put upon said material, if the same should be damaged or destroyed by fire. Some of the materials were destroyed by fire and the plaintiff claimed the value of work performed, $575 less

$5.75 to be deducted. The defendants contended that the contract sued upon was a contract of insurance and as such was invalid as the defendants had not complied with the insurance law.

The Appellate Term held that this was not insurance, and said (pp. 424–425):

> An analysis of the contract shows that it lacks an essential element to enable it to be treated as a contract of insurance. There can be no contract of insurance unless there be a risk insured against. As Lord Mansfield said, in the early case of *Tyrie* v. *Fletcher* (Cowp. 666): "The underwriter receives a premium for running the risk of indemnifying the insured and whatever cause it be owing to, if he does not run the risk, the consideration for which the premium or money was put into his hands fails, and therefore he ought to return it."
>
> In the contract under consideration the defendants ran no risk. They were obligated to pay the plaintiff, for his labor absolutely and unconditionally. If the goods were not destroyed, they were bound to pay the plaintiff, and if the goods were destroyed they were required to pay him. * * * The defendants' obligation was merely to pay the plaintiff for his labor, and this labor was necessarily to be performed before the goods were destroyed. The defendants' obligation was in no sense contingent. If the goods were not destroyed, they were required to pay the plaintiff for his labor when the goods were returned to them. If the goods could not be returned to them on account of their destruction by fire, they were also to pay the plaintiff for the labor which he had performed upon them up to that time. In either event the defendant's obligation to

pay was absolute. In no event was the obligation of the defendants to pay contingent upon any risk. Any risk which the defendants ran related to the goods and not to their obligation to pay for the labor of the plaintiff. The payment which the defendants agreed to make was not to be made to the person who suffered the loss. The payment was to be made to the person hired for the services which he had rendered.

In *Commonwealth* v. *Provident Bicycle Asso.*, 178 Pa. St. 636, the court held that a corporation which accumulated a fund by assessment from its members and agreed to clean and repair the bicycles of members and replace bicycles destroyed or stolen was not engaged in the insurance business within the meaning of the insurance law of that State.

In *Hansen* v. *Dodwell Dock & Warehouse Company,* 100 Wash. 46, the plaintiff below sued his employer for damages resulting from personal injuries caused by an assault while he was in the employ of the defendant. The plaintiff, who was employed at the time of a strike, based his action upon a contract by which his employers agreed to furnish him a safe place in which to work "free from assault on the part of any persons whatsoever." The court held that this contract was not void as a contract of insurance within the meaning of the laws of the State relating to that subject.

In *Cole* v. *Haven,* 7 N. W. 383 (Ia.), the plaintiff sued upon a contract under which the defendant installed lightning rods and agreed to

make good "all such immediate loss or damage as may occur by lightning communicated directly to said building, * * * to an amount not to exceed $500." The court held that the contract was not void as a contract of insurance made by a person who had not complied with the laws of Iowa in relation to insurance companies.

Evans & Tate v. *Premier Refining Co.*, 31 Ga. App. 303, involved a contract by which, in consideration of the purchase of lubricant, the plaintiff "insured the defendants against the breakage, by natural wear and tear of the gears of the automobiles of such persons as purchased the lubricant from the defendants." The court held that this was not a contract of insurance within the meaning of the statute requiring a person to obtain a license before transacting insurance within the State.

See also *In re Denton's Estate* (1903) 2 Ch. 670; (1904) 2 Ch. 178.

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